GEO
Guyana Economic Opportunities

Study into the Proposed Reduction of the Rates of Consumption Tax paid by Manufacturers in Guyana

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STUDY INTO THE PROPOSED REDUCTION OF THE RATES OF C-TAX PAID BY DOMESTIC MANUFACTURERS

Proposal for the Reform of
the Consumption Tax System in Guyana

JULY 2001

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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

This Report presents the results of an examination on the possibility for the reduction of consumption tax rates on goods produced by domestic manufacturers following a proposal by the Guyana Manufacturers Association (GMA). The Study did not examine the wider issue of taxation or the economic impact of specific taxation measures.

In its Year 2000 Budget submission, the GMA made a proposal to the Government for the replacement of Consumption Tax on locally produced manufactured goods as well as the elimination of duty free concessions on inputs to manufacturing by an across-the-board 10% tax or duty on raw materials and inputs to manufacturing. This proposal is not new. A study in 1991 recommended a similar proposal noting that it would involve no loss of revenue.

A survey carried out before the submission of the draft of this Report revealed that sixty-nine percent (69%) of the respondents supported the original proposal of the GMA while 72.5% believed that a uniform rate of C-Tax and the removal of exemptions would address some of the more pressing needs of manufacturers. Respondents wanted the Government to implement immediate C-Tax reform despite the likelihood of VAT being introduced in the short to medium term. Some larger manufacturers expressed reservations with the original proposal, particularly the removal of existing exemptions and zero rating from which they currently benefit.

Following the submission of the draft of this Report, the GMA re-considered its position and put forward a revised proposal for an across-the-board 15% tax or duty on raw materials and inputs to manufacturing, except for alcoholic beverages, tobacco and tobacco products, petroleum and flour to remain at their current rates. Under the revised proposal duty free concessions on inputs to manufacturing shall continue. For purposes of this report “proposal” refers to the GMA's revised proposal unless otherwise stated.

The Report did not carry out an in-depth examination of the implications of the withdrawal of certain current facilities. It notes however, that should the Government accept the GMA’s proposal, its revenues would increase, the system would become more efficient and much less business energies and Ministerial time would be consumed dealing with requests for waivers and exemptions.

The preparation of this Report was adversely affected in its scope because the necessary information is not available at any central location, or in a form which allows sufficient disaggregation and analysis. We have had to rely on data contained in the Macro-economic Framework of the National Estimates, data published by the Ministry of Finance and Bank of Guyana and on figures generated by the International Monetary Fund. We also referred to several earlier studies on the subject as well as the National Development Strategy.

For a number of reasons, the manufacturing sector in Guyana has remained fairly small and has not made any significant contribution to the economy. The sector has had to survive a regime of high taxes, import controls, declining rate of the Guyana currency, uncompetitive (high) utilities cost, and a small domestic market, often competing with smuggled goods. To compensate for these, the sector enjoyed extensive and expensive protection provided by the Government mainly in the form of tariffs and tax incentives.

Despite its poor performance thus far, the sector can become competitive in the production and export of manufactured products utilising the country's rich, commercially exploitable natural resources but requires the establishment of a tax and regulatory framework and the necessary infrastructure to promote such competitiveness. This Report looks at the Trinidad & Tobago regime for the sector, which offers some guidance to the authorities in Guyana. It notes however, that the conditions prevailing in Trinidad and Tobago have been largely facilitated by the success of its economy led by the petrochemical sector. Guyana would have to be cautious in following any external model or one that leads to further distortions and subsidies.

C-Tax has never been popular both among manufacturers especially, and importers who have complained that the tax is onerous, disadvantageous and excessive. Indeed in sub-sectors which have had no reduction or relief such as furniture and printing, a number of businesses have either gone out of business or underground as a result of the punitive 30% tax rate. An examination of budgets presented by the various administrations over the past ten years revealed constant changes in the rates charged on a number of items suggesting either that the tax is indeed too burdensome or the policies in forming this tax is unclear.

There are currently two hundred and sixty nine (269) registered manufacturers and they are exempted from C-Tax on all directly imported and domestically produced inputs purchased from registered manufacturers. Despite this legal exemption, most manufacturers have indicated that they pay C-Tax on their inputs. The exemption would normally be a substantial incentive for compliance, but it is widely believed that a significant number of persons do not register. It seems that one reason for non-compliance is that the enforcement mechanisms are considered weak and therefore the probability for detection is low or the penalties not of a sufficient deterrent.

The entire tax system in Guyana including C-Tax, is characterised by remissions and exemptions which distort allocative efficiency, lack transparency and lead to considerable uncertainty. As a result, the tax base is reduced requiring high rates which in turn lead to evasion and calls for further exemptions. Goods relieved of Duties and or Taxes in 1999 amounted to over 20% of all imports, including the C414 category (Diplomatic Missions, International Organisations and Personnel) amounting to G$1.2B and the C461 category (Goods Relieved of Duties/Tax) amounting to G$18.9Bn.

Earlier studies have identified several weaknesses and anomalies in the C-Tax regime some of which the NDS has addressed. This Report also highlights two continuing problems of valuation and definition first raised in the Crittle Report.

As did the earlier studies, the NDS recommends a reduction of the tax burden by introducing a lower uniform rate instead with special higher rates remaining on certain classes of products. Like the NDS, this Study is conscious of the revenue concerns of the government and its recommendations protect government's revenue targets while reducing the burden on consumers.

While the impact of changes in the C-Tax rates on individual enterprises and on consumers does not form part of the Terms of Reference of this Study, it is useful to note that manufacturers have indicated that as a rule, the cost of the C-Tax is passed on to the consumer. On the other hand, consumers do not automatically benefit from reductions particularly if the C-Tax forms part of the input as experience has shown in the case of reductions in C-Tax on gasoline, Av-Gas and raw material.

Based on imports data published by the Bank of Guyana, the effective rates of Consumption Tax on total imports for the years 1997-1999 have been 8.61%, 8.83% and 8.89% respectively while the average of the effective rates of customs duty have been approximately 4% for each of the years, giving a combined rate of approximately 13% on imports. With approximately 25% of imports subject to exemptions and remissions, the effective rates on taxable imports are C-Tax 12% and duties 5%.

Although C-Tax collections over the six-year period 1995 to 1999 increased by some $4.1Bn, the largest increase ($2.8Bn) occurred from 1994 to 1995. The increase took place in both imports and domestic manufacturing which increased by 50% and 52% respectively. This is despite the reduction in rates and reflects in part changes in the exchange rate and inflation.

Approximately G$12Bn representing 32% of total tax revenue is collected annually as consumption taxes of which $8.6Bn is derived from imports and $3.1Bn from domestic manufacturers. The substantial contribution of C-Tax to total revenue explains Government's caution in responding to any request for an across-the-board decrease of rates of C-Tax.

The top five payers of domestic C-Tax are Banks DIH Limited, Demerara Distillers Limited, National Milling Company, Torginol Guyana Limited and Edward B. Beharry & Company Limited. It is estimated that in total, these five companies account for approximately 92% of the Consumption Tax received by the Government in 1999.

Using 1999 C-tax collections, at least G$2,669Mn or 86.1% of domestic collections will not be affected by the changes proposed by the GMA. Indeed if the revised proposal was accepted in its entirety there will be a net increase of G$254Mn in revenues. On the other hand if existing exemptions and zero rates were removed, and if steps were taken to reduce remissions and strengthen enforcement the potential gain would be $404Mn.

This Report shares the view of earlier studies that special rates need to be maintained on certain products such as alcoholic beverages, petrol and tobacco products and that the rate reductions should be applied only to other manufactured products. In accordance with Article 24 of Protocol IV, any reduction will also apply to Caricom imports and there will not be any competitive advantage gained by domestic manufacturers. Indeed some manufacturers have expressed the view that lower C-Tax rates could lead to a flood of Caricom goods into Guyana and the loss of the competitive advantage which domestic manufacturers assume by very creative costing and pricing practices. On the other hand the lower rates can make smuggling and evasion less attractive and collections will increase.

This Report considers that the options available to the government range from accepting the GMA’s proposal to its rejection with several intervening possibilities. This Report offers three principal options with one option offering at least five possibilities. It is possible that there can be further permutations of these.

This Paper for the reason of tax efficiency, resource allocation, reduction of political intervention in the tax system and the removal of uncertainty supports both the GMA's original proposal i.e. Option 3 II) i.e. a flat rate of 10% and the removal of zero rates and exemptions now available to manufacturers and the GMA's revised proposal i.e. Option 3 V) i.e. a flat rate of 15% while retaining zero rates and exemptions.

It recommends however, that changes of a more fundamental nature should be made on the basis of a comprehensive tax reform process to the tax system in which all interested parties have the opportunity to participate.

Not only will this produce increased revenues but it will also remove the distortions inherent in the current system, reduce remissions and make the entire process more transparent. This is likely to meet with objections from some manufacturers who claim that they will lose their competitiveness. Those manufacturers who can prove that the change will seriously harm their business can make recommendations for the new measure to be applied to them or phased in over one or two years.

The Report further recommends that changes of a more fundamental nature should be made on the basis of a comprehensive tax reform process in which all interested parties have the opportunity to participate.

Meanwhile the following steps should be taken to advance Consumption Tax reform:

1. The Reports by Welling, Crittle and the IMF should be referred to a Select Committee within the Guyana Revenue Authority for review and implementation.

2. The basis of valuation for purposes of C-tax, particularly in the case of manufacturer/ distributor needs to be clarified.

3. The C-Tax Act and Schedule should be consolidated and simplified.

4. A public information programme should be designed to encourage compliance with the law.

5. There should be established a Statistical Unit in the GRA to ensure that data are collected and maintained in a manner useful for planning purposes.

6. There should be established in the Ministry of Finance, a Tax Policy Unit charged with the responsibility for considering and recommending various options available within the fiscal system.

7. Guidelines subject to the approval of Parliament should be established for the granting of remissions and waivers.

8. Certain categories of items that enjoy remission should be reviewed and if necessary investigated.

9. A census of manufacturers should be carried out to bring all manufacturers on the Register.

10. The existing threshold for exemption needs to be reviewed and increased.

One of the benefits of C-Tax reform is that the introduction of VAT will be facilitated while addressing the legitimate concerns of the domestic manufacturing sector.

CHAPTER 1

INTRODUCTION

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CHAPTER 1 - INTRODUCTION

1.1 Overview

This Report presents the results of an examination designed to ascertain whether it is possible for consumption tax rates to be lowered for domestic manufacturers. In carrying out this engagement we did not examine the wider issue of taxation or the economic impact of specific taxation measures.

Despite sustained criticisms over several years and widespread dissatisfaction with the tax as evidenced by comments in successive Budget Speeches, complaints from the private sector and reports of international donor agencies, a number of the deficiencies persist in relation to the administration, rates and impact of the tax. With comparisons often being made with and calls by Guyanese manufacturers for the establishment of a similar environment, this Report examines the manufacturing sectors and incentives offered in Guyana and Trinidad and Tobago in Chapter 1.

In Chapter 2, we examine the history and evolution of the tax, look at the administrative machinery, identify a number of deficiencies of the system, analyze profiles of the top payers of C-Tax and report on two workshops which were held with manufacturing companies as part of this study.

In order to understand other Caricom countries' experiences, we sought information from Trinidad and Tobago, Barbados, Jamaica and Antigua, the latter of which is perhaps the only country in the region which currently has a consumption tax similar to Guyana. We also look at these in Chapter 2.

In the course of the preparation of the Report, we reviewed several previous reports on the subject and in particular the Final Report titled "A Review of the Application and Administration of Consumption Tax in Guyana" prepared by Mr. F. J. Crittle. Summaries of the main findings of these reports are presented in Chapter 3.

In Chapter 4 we examine the principal features of the tax system, revenue structure of the Central Government, the implications of any reduction in the rates and suggest possible avenues for recouping any losses from such reductions. We also look at the top five major companies measured by their contribution to the revenue from consumption tax and consider the nature of their businesses.

As we noted above, several studies have been done of this tax over the past ten or so years. We have reviewed the reports arising out of those studies to determine the extent to which their recommendations are still relevant. We report our findings in Chapter 4.

Finally in Chapter 5 we identify the options available to the government and make our conclusions and recommendations.

1.2 Background to the Engagement

The Guyana Manufacturers Association (GMA) made an initial proposal to the Government for the replacement of Consumption Tax on locally produced manufactured goods as well as the elimination of Duty Free concessions on inputs to manufacturing by an across-the-board 10% tax or duty on raw materials and inputs to manufacturing.

Conscious of the implications of International Monetary Fund conditionalities and fiscal requirements, the Government is concerned with the revenue impact of such changes.

In October 2000, the USAID-funded GEO Project in collaboration with the GMA invited proposals from qualified firms to conduct a study on and prepare a position paper for the reform of C-Tax on products manufactured in Guyana as proposed by the GMA.

Following the submission of a proposal dated October 30, 2000, Ram and McRae was awarded the contract on November 7, 2000 to conduct the study and prepare the position paper.

Upon the submission of the draft Report, the GMA re-considered its position and put forward a revised proposal for an across-the-board 15% tax or duty on raw materials and inputs to manufacturing, except for alcoholic beverages, tobacco and tobacco products, petroleum and flour which would remain at their current rates.

1.3 Terms of Reference

The purpose of the engagement as set out in Section A2: Scope of Work of a contract between Chemonics International Inc. and Ram and McRae is to assist the GMA in developing a position paper which makes a case for the reduction of the rates of Consumption Tax payable by domestic manufacturers and simultaneously respond to Government's concern over any loss of revenue resulting from any reduction in rates. Among the factors to be considered in developing the position paper are:

- Government revenue from the current system involving duty free concessions and the consumption tax on manufactured goods.
- Administrative costs or other disincentives to local manufacturers under the current system.
- Estimated Government revenue from a flat 10% duty or tax coupled with the elimination of duty free concessions and the Consumption Tax, or alternatively, the Tax or Duty rates needed to meet current revenues from the existing system.
- Impact on the use of imported versus domestic inputs.
- Equity in taxation and incentives associated with the importation of finished manufactured goods vs. local production of the same or similar goods.
- Other relevant factors or issues not included here, but which the Subcontractor believes are important to the analysis.

The Report is required to consider the likely impact on the revenues of the country if the proposal was accepted and to establish a case based on sound economic analysis for enacting the reforms. Under the Terms of Reference Ram and McRae is required to:

- Meet with officials of the Geo Project and the GMA to review/ refine the scope of the engagement and the deliverables;
- Research previous studies done on the subject including the Beauregard, Crittle and Welling Reports, the National Development Strategy, Caricom's publication on the Common External Tariff (CET) and previous budget speeches;
- Review and summarise the current Consumption Tax Act, noting in particular zero rated and exempt goods;
- Prepare and implement a questionnaire for manufacturers to assist in addressing current impacts of the C-Tax system on local manufacturers;

- Review published statistical information on production, imports and exports to identify items which fall under the C-Tax regime and those which are exempt;
- Meet with officials of the Statistics Bureau, Bank of Guyana, Customs Administration, the Ministry of Finance and some of the largest payers of C-Tax to obtain additional relevant information;
- Examine the regime for the manufacturing sector in Trinidad and Tobago which has the most successful manufacturing sector in the Region.

The Executive Summary has been so constructed to allow it to form the basis of the Paper to be submitted to the Government.

1.3.1 Data Problems

Despite our best efforts and based on discussions with members of the Guyana Revenue Authority, it appears that the system does not generate adequate data to allow for the quantification of the real costs/ revenues from alternative tax measures.

The information that is available is not in a form which allows sufficient disaggregation and analysis. Accordingly, we have had to rely on information contained in the Macro-economic Framework of the National Estimates, data published by the Ministry of Finance and Bank of Guyana and figures generated by the International Monetary Fund.

In referring to this deficiency in available information, the staff of the IMF Fiscal Affairs Department note in their study "Guyana: Toward a Medium Term Strategy for Tax Policy and Tax Administration":

> *"Apart from imports-based data on value added and associated import duties and consumption taxes, virtually no analytical data relating to the data distribution of the various tax bases could be obtained."*

1.4 Methodology Employed

Ram and McRae met with a large number of individuals and groups from business and Government as well as Caricom officials. These included:

- Officials from the Customs and Trade Administration Division of the Revenue Authority
- Caricom Secretariat
- Guyana Manufacturers Association
- Banks DIH Limited
- Demerara Distillers Ltd.
- Continental Group of Companies

Despite several requests, we were unable to meet with officials of the Statistics Bureau.

In addition, two Workshops were held to discuss GMA's proposal and to obtain the views of manufacturers/ importers. These enabled Ram & McRae to consult in an interactive group setting with a wide cross-section of the manufacturing sector in Guyana.

A wide variety of reports, legislation and both published and unpublished statistics were analysed in the preparation of this Report.

1.5 The Manufacturing Sector in Guyana

The manufacturing sector in Guyana is relatively small and its performance over the past ten years has at best been erratic. As Table 1 (on the next page) shows, if we exclude sugar production and rice milling, the rest of the manufacturing sector which also includes electricity, gas and water accounted for less than seven percent of GDP for the years 1996-1999. For the years 1989 to 1991 prior to the Economic Recovery Programme (ERP) coming on stream, the comparable percentage was 7.7%. If we were to go back further, we note that the sector's share of GDP was actually higher in 1950-1975 than it has been in recent years[1]. In other words, the domestic manufacturing sector has not responded to the economic reform programmes and several attempts to ease the tax burden on the sector for which they have persistently advocated.

While apparently alarming, this situation merely reflects the low level of economic development in the country and the small size of the domestic market. Per Capita GDP expressed in United States Dollars which in 1991 was $420 rose to $746 in 1999. However, despite this increase, Guyana still remains one of the poorest countries in the Western Hemisphere and its import pattern and revenue structure reflect this level of development. In the classical model, as development occurs more and more manufacturing and services occur within the country and imports of manufactured goods – consumption, intermediate and capital – fall as a percentage of total imports. This has not been happening in Guyana: indeed as we have seen, in the manufacturing sector at least, the reverse has taken place.

Outdated equipment and technology, weak financial structure, poor economic policies, untrained management and a small domestic market have all contributed to this situation. Guyanese manufacturers regularly attribute their inability to compete with official and unofficial trade to the application of the Consumption Tax.

Domestic manufacturers are subject to both direct and indirect taxes. They pay Consumption Tax on their locally sold output and certain manufacturers face Excise Duty as well. Further they are required to pay import duty on their imported material inputs but are exempted from Consumption Tax on directly imported material inputs and all domestically sourced material inputs. They receive capital allowances on historical costs and pay corporate income tax at the rate of 35%.

There are other compliance costs associated with several pieces of legislation including the Customs and Consumption Tax Acts, the Companies Act, 1991, the Occupational Health & Safety Act, the Termination of Employment and Severance Pay Act and the National Insurance & Social Security Act. Both the financial and non-financial costs of compliance are quite considerable and may explain the failure of the country's small and medium size operators to develop.

In the era when Guyana pursued policies of self-sufficiency and had a draconian exchange regime in place, the Government sought to compensate for these externalities by offering various forms of protection including restrictions on imports and fiscal and other concessions. While many of these

[1] Revised National Development Strategy Report

practices have long been discontinued, successive governments have persisted in using fiscal policies to influence economic decisions while the manufacturer has continued to look to the government for various forms of assistance.

The catastrophic decline in the performance of the economy and the standard of living, particularly during the eighties suggest that efforts to promote efficient import substitution via the provision of assistance to domestic manufacturers through tariff protection, duty free access to raw material inputs and capital items, the availability of subsidised credit and tax holidays have been largely unsuccessful. Indeed the evidence suggests that these efforts have not only failed but have involved significant and perhaps permanent costs to the sector and the economy.

GROSS DOMESTIC PRODUCT (AT 1988 PRICES) (G$Million)

Item	1989	1990	1991 1)	1992	1993	1994	1995	1996	1997	1998	1999
GDP AT FACTOR COST	**3422**	**3319**	**3519**	**3792**	**4104**	**4453**	**4676**	**5047**	**5360**	**5269**	**5426**
AGRICULTURE, FORESTRY AND FISHING	**909**	**784**	**881**	**1095**	**1160**	**1302**	**1412**	**1516**	**1576**	**1474**	**1672**
Sugarcane	391	308	379	576	575	598	595	657	649	600	755
Rice Paddy	64	42	67	75	93	103	140	148	151	150	162
Other crops	186	195	195	193	203	215	233	242	255	272	275
Livestock	94	66	55	54	60	69	84	105	111	109	111
Fishing	102	102	113	109	112	120	132	135	146	142	143
Forestry	72	71	72	88	117	197	228	229	264	200	226
MINING AND QUARRYING	**266**	**314**	**381**	**337**	**502**	**535**	**474**	**546**	**628**	**645**	**591**
Bauxite	210	262	317	209	418	217	234	235	234	239	219
Other	56	52	64	128	84	318	240	311	394	406	372
MANUFACTURING	**426**	**370**	**409**	**488**	**505**	**533**	**583**	**616**	**631**	**576**	**652**
Sugar	124	98	120	183	182	190	188	207	205	190	239
Rice	25	17	27	30	36	41	54	58	59	59	63
Other 2)	277	255	262	275	286	302	241	351	367	328	350
CONSTRUCTION	**241**	**246**	**251**	**256**	**265**	**318**	**349**	**398**	**450**	**471**	**424**
SERVICE	**1580**	**1605**	**1597**	**1616**	**1672**	**1765**	**1858**	**1971**	**2075**	**2103**	**2087**
Distribution	278	287	301	316	338	358	376	395	417	439	404
Transport and Communications	284	290	290	299	317	344	375	416	453	439	448
Rental of dwellings	65	66	66	66	66	72	77	82	88	93	87
Financial services	194	200	200	204	214	231	249	273	285	294	300
Government	634	634	609	597	597	609	621	633	651	650	657
Other 2)	125	128	131	134	139	151	160	172	181	188	191

1) Components may not add to the total due to rounding

2) Includes electricity, gas and water

Figure 1: GDP at 1988 Prices
(Source: Bank of Guyana Annual Report 1999)

Not only did manufacturers not take advantage of the protection to strengthen their operations, but subsequent developments indicate that some domestic manufacturing operations in receipt of concessions were conducted inefficiently. With the removal of import and exchange controls domestic manufacturers found it difficult to compete with imported goods. Productivity remains a major issue for the manufacturing sector and lowering of C-Tax rates is one, but significant, element in enhancing competitiveness. The evidence suggests that there is a simultaneous need for substantial improvement in productivity in many enterprises to enable them to compete effectively.

Despite the relatively poor performance of the sector, no country can afford to ignore its manufacturing operators and it must constantly seek out opportunities to create and support industries which make a net contribution to the economy by providing jobs, generating foreign exchange earnings or providing savings in foreign exchange as a result of import substitution.

"Manufacturing" is of course a wide term even if rice and sugar milling were excluded. As defined by the Consumption Tax Act it means "making goods or applying any process in the course of making goods". This definition includes not only agro-processing but also involves the application of technical knowledge and processing equipment, in alliance with capital and labour transformation of locally available or imported raw materials and/or intermediate inputs, into final or intermediate products. These include agricultural, industrial and mineral materials.

Given its manifestly rich, commercially exploitable natural resources, Guyana should readily develop the required competitive advantage for the production and export of manufactured products. While the manufacturing and agro-processing sector offers considerable scope for expansion in the future, it appears that at present a significant number of our industries will have difficulties competing with regional and international competitors. The National Development Strategy refers to a study of the manufacturing cost structure of Jamaica, St. Lucia, Grenada, and Guyana which found that Guyana was the *least* competitive of the countries despite having the lowest wage rates. The Report added that in Guyana, the cost of energy and transport was double that of the other countries; the transaction costs, which include the time spent in consultations with the Government, were deemed to be the highest; and the technology that was generally utilised in the manufacturing processes was considered to be inappropriate or inadequate.

The NDS recommends that to overcome the limitations of market size, to take account of economies of scale and to earn vital foreign exchange, the country has to become an export-oriented economy with cost and quality that can compete in the international market place. The NDS recommends that the very top priority must be assigned to sustaining a policy framework that aids competitiveness. This includes the further liberalisation of the economy to the point where the remaining vestiges of protectionism which sheltered and nurtured policies of import substitution manufacturing are dismantled. The NDS recognises however that provisions may be necessary for the stimulation of infant industries and the development of certain geographical areas of the country.

The National Development Strategy recommends a number of policy measures to be accorded the highest importance, if the manufacturing sector is to prosper in the future. Some of the areas recommended in the policy framework include labour force training, improved mechanisms for industrial relations, a more uniform and liberal tax regime, and the maintenance of a stable exchange rate over time. Other measures recommended by the NDS if Guyana is to come anywhere close to overcoming the competitive disadvantage *vis-a-vis* other countries in the region include:

- Further reduction in the rates of corporate taxes on manufacturing enterprises in order to widen the existing differential between the manufacturing and commercial sectors, thus encouraging more investment in manufacturing;

- Widening the scope for fiscal incentives for value-added export products by way of an export allowance;

- Investors should be encouraged, through a package of incentives, to locate their manufacturing enterprises in certain areas of Guyana (for example, the Intermediate and Rupununi Savannahs; and Regions 1, 2, 7, 8, 9 and 10) in order to place industries closer to the raw materials wherever possible, to attain an equitable distribution of economic activity, and to occupy the hinterland;

- Investors should be encouraged to establish townships within these areas, to facilitate the recruitment of personnel and to provide amenities to workers;

- The duty and consumption tax rates for a wide range of machinery and equipment as well as imported raw materials to be reduced to zero;

- Provision of additional accelerated allowances for capital expenditure, depending on the rate of expenditure incurred;

While this Report does not necessarily agree with all the recommendations of the NDS and notes that some of them are already in place, it acknowledges that the case for removing impediments to, and facilitating the development of the manufacturing sector including its various sub-sectors, is a strong one.

1.6 Taxation of and Incentives to Manufacturing Sector in Trinidad and Tobago

Incentives and the infrastructural and regulatory arrangements for the manufacturing sector in Trinidad are very different from those available locally. These are often used by the private sector in Guyana as a model for a successful sector. On account of cost and the need for wider reforms, Guyana cannot afford to institute such arrangements, although they merit consideration and discussion with the manufacturing sector.

1.6.1 Introduction to the Trinidad System

Trinidad & Tobago now has one of the most successful and aggressive manufacturing sectors in the entire Caribbean. We examined some of the more prominent features of the legislative, fiscal and regulatory arrangements in place in that country which have contributed to the sector's success. In terms of legislation, the following Acts provide substantial tax incentives to support and encourage local industry:

- ✓ the Corporation Tax Act (as amended);
- ✓ the Income Tax Act (as amended);
- ✓ the Income Tax (In Aid of Industry) Act 1950 (as amended);
- ✓ the Fiscal Incentives Act 1979 (as amended); and
- ✓ the Free Zones Act 1988(as amended);

Under the above-mentioned Acts total or partial relief, usually in the form of tax holidays, exemptions or reductions for a specific period of time is available as follows:

- ✓ industry incentives to approved enterprises;
- ✓ industry incentives to approved small companies, regional development companies and approved activity companies;
- ✓ export incentives; and
- ✓ free zones;

1.6.2 Fiscal Incentives for Industry

Approved Enterprises

Under the Fiscal Incentives Act substantial tax and non-tax benefits exist for approved manufacturing industries. To be eligible for approved enterprise status, an enterprise must be incorporated in Trinidad and Tobago, be resident there and have its centre of management and control in the territory. The Fiscal Incentives Act created five categories of enterprise and specified the tax holiday periods applicable to each:

- group 1 enterprise: the local value added content of the product manufactured is at least 50%, a tax holiday period of 9 years;
- group 2 enterprise: the local value added content is at least 25% but less than 50%, a tax holiday period of 7 years;
- group 3 enterprise: the local value added content is at least 10% but less than 25%, a tax holiday period of 5 years;
- enclave enterprise: the product manufactured is exclusively for export to countries outside the CARICOM region, a tax holiday period of 10 years;
- highly capital-intensive enterprise: the capital investment is at least TTD 50 million, a tax holiday period of I0 years.

Any one or more of the following benefits may be granted to an approved enterprise in respect of an approved product:

- total or partial relief from corporation tax;
- unlimited set-off against net losses for a period of 5 years;
- customs duty exemption;
- income tax exemption on dividends payable out of profits during the tax holiday period; in the case of non-residents this exemption is limited to the level of exemption enjoyed by the shareholder in his country of residence. Interest on loan capital or other borrowings is, however, subject to tax.

A number of products for which markets are already well established, or which were granted benefits under a previous Act, are generally excluded from the definition of an approved enterprise. Similarly, relief is not usually granted to an established product where domestic production supplies at least 60%

of the local market. The President of the country may, however, vary this restriction in certain circumstances.

An approved enterprise is required to maintain such records and submit such returns of performance during the tax holiday period as directed by the Minister. The enterprise is also required to keep a record of all items imported duty-free during the period.

The Minister is empowered to appraise performance of an approved enterprise at the end of three years from the commencement of production and every two years thereafter during the tax holiday period.

1.6.3 Compliance

Provisions exist for reclassification of an approved enterprise from one category to another if it fails to maintain its classification and for subsequent variation of the holiday period to coincide with the revised classification.

In the event of breach or non-compliance of the enterprise with its obligations, the Act provides for revocation of approved status by the Minister. Approved status will be revoked in the event of:

- failure to begin production;
- cessation of operations within the first 3 years of production;
- contravention of regulations and conditions imposed.

Termination of the approved status upon application by the approved enterprise is also provided for.

Revocation acts as if approved status had never been granted and negates any benefits conferred. All corporation tax and customs duties that would have been payable during the period of operations, subject only to loss offset provisions, become due.

In the event of termination, all benefits and tax relief cease as from the date of termination.

1.6.4 Approved Small Company Incentives

Under the Corporation Tax Act an approved small company that:

- is locally owned and controlled
- has machinery, equipment and working capital not exceeding TT$ 500,000;
- has potential for permanent job creation; employs at least five persons; and
- uses local raw materials in production.

is eligible for a tax credit equal to 15% of taxable profit for a continuous period.

1.6.5 Regional Development Companies

Under the Business Expansion Scheme, introduced in 1988, approved companies operating within a designated regional development area are entitled to a tax credit equal to 15% of taxable profit for a period of 5 years. The qualifying criteria for such credits are:

- incorporation on or before 8 January 1988
- local ownership and control;
- potential for job creation;
- operations must be located within the regional development area; 75% of assets must be located in that area; at least 20 persons must be employed.

In 1993 this scheme was expanded to encourage both individual and corporate investment in venture capital companies, a tax rebate being granted on such investment. Profits of such companies, as well as dividends in the hands of shareholders, are tax exempt. However, the enterprises in which the venture capital is invested must be export oriented.

1.6.6 Approved Activity Companies

Under the Corporation Tax Act a company may be granted approved status if it employs ten (10) or more persons and is capable of

- earning hard currencies or effecting savings of foreign exchange;
- creating a significant number of permanent jobs or has potential for expansion;
- stimulating technological development or developing new and modern industries; or
- making efficient use of local raw materials.

Such an enterprise is also eligible for a 15% tax credit for a period of five years.

1.6.7 Export Promotion Incentives

In an effort to encourage exports of locally produced goods and reduce reliance upon the energy sector, a number of incentives has been introduced for exporters, especially those producing non-traditional goods and developing non-traditional markets.

Export Allowance

This is available to manufacturing enterprises with certain exceptions. Export sales to CARICOM countries are not eligible; neither are a variety of specified products enjoying concessions under the Fiscal Incentives Act and earlier legislation. A further exclusion is the petroleum industry to which a separate tax and incentive regime is applicable.

Promotional Expenses

Expenses incurred in the expansion of existing markets and the creation of new markets by companies, sole traders and persons engaged in agriculture are tax deductible at 150% of the actual outlay. Such expenses are defined as:

- advertising in foreign markets;
- promotional literature for overseas distribution;

- provision of free samples and technical information on the products;
- participation in trade fairs, missions and similar activities;
- overseas travel for purposes of the above activities;
- invitations to overseas buyers in Trinidad and Tobago;
- recruitment of specialist sales personnel in foreign markets for a maximum period of 2 years.

Value Added Tax Exemption

On imported input when 80% or more of production is exported.

Import Duty Rebate

On exports implemented on the basis of 1 l/2% of export sales FOB.

Market Development Grants

The Export Development Corporation (EDC) is empowered to make market development grants to exporters. These grants are exempt from tax provided they have been made in respect of expenses incurred prior to the export of the first commercial shipment of goods produced in Trinidad and Tobago, and the target market is not an excluded country, i.e. within the CARICOM region.

Such grants are made available to companies meeting certain requirements laid down by the EDC. Qualifying expenses include research costs, market testing, product design and consultancy, overseas travel for conducting market research, product testing by overseas agencies to ensure it meets required standards in the target market. These grants are only available to companies resident in Trinidad and Tobago.

Export Credit Facilities

Export credit facilities are offered to exporters by the Export Credit Insurance Company Limited, set up under the aegis of the EDC.

1.6.8 Free Zones

The Free Zones Act 1988 made provision for the establishment of free trade zones in Trinidad and Tobago, under the management of the Trinidad and Tobago Free Zones Company Limited. Within the zones goods can be manufactured, assembled, inspected, repaired, modified or simply stored in a tax and duty-free environment. Such goods are deemed to be in international commerce. All goods exported or transferred between free zones remain duty-free.

Strategically located within the Point Lisas Industrial Estate the area has access to a deep-water harbour, excellent port facilities, a teleport and abundant cheap energy along with the necessary infrastructure to make it an ideal location for export processing enterprises.

The country is considering the establishment and operation of privately developed and managed free zones.

Benefits to be derived from operating within a free zone include:

- an unlimited tax holiday in respect of corporation tax on profits and withholding taxes on remittances to non-resident shareholders;
- exemption from import duties on machinery, equipment, raw materials and building materials used for the purpose of the enterprise;
- exemption from VAT on goods imported into the zone;
- export/import licensing is not required;
- unlimited repatriation of capital, profits and dividends; and
- investors may operate in any currency provided it is freely exchangeable on the open market.

CHAPTER 2

CONSUMPTION TAX

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CHAPTER 2 – CONSUMPTION TAX

2.1 In Guyana

2.1.1 History of Consumption Tax

Consumption Tax is an expenditure tax of the same class as Customs and Excise, purchase tax, stamp duties and licence duty. C-Tax was introduced in 1969 to recover revenues foregone as a result of the duty free admission into Guyana of goods from Caricom countries. The Consumption Tax Act provides for the imposition, collection and enforcement of the tax.

The Act charges varying rates of taxes on registered manufacturers and importers. Domestic manufacturers are required to register with the Customs & Trade Administration, but the Act gives the Minister the authority to exempt, by Order, very small businesses by reference to minimum sales of chargeable goods or such other criteria as he may decide.

The Tax has never been popular both among manufacturers especially, and importers, who have complained that the Tax is onerous, disadvantageous and excessive. In a recent Survey conducted by Ram and McRae, manufacturers identified high rates, weak enforcement and substantial compliance costs as hampering the development of the sector. These sentiments have found mixed sympathies with successive Ministers of Finance as reflected in extracts from Budget Speeches over the years. While there have been continual reduction in the rates and efforts at simplification, there have been concerns that the "concessions" have not always produced the desired results i.e. they have not been passed on to the consumers or led to any discernible improvement in the manufacturer's fortunes.

The empirical evidence is that particularly in cases where the C-Tax is on inputs or where the C-tax is not evident on the invoice value of sales, rate reductions do not automatically benefit the consumer as has been the case with the reduction in Av-gas and Av-jet fuel.

The following changes have been announced in Budget Speeches over the past ten years.

<u>1988</u>

The Minister announced the Zero Rating of books and reading (educational) materials which then attracted a 30% consumption tax.

<u>1989</u>

The rate of customs duty paid on beer manufactured in Guyana for consumption in Guyana was increased by 65% from $18 per liquid gallon to $29.70 per liquid gallon.

<u>1990</u>

The Minister announced sweeping changes in the C-Tax regime and referred to the need to redesign the structure of Consumption Tax to reduce the incentive for tax evasion (both under-invoicing and smuggling); to promote economic efficiency; and to ease the burden on consumers. Government took initiatives such as improving assessment and collection, and elimination of a sizable portion of exemptions.

He also referred to the across-the-board rate reduction as weak and noted, perhaps with some exaggeration, that for many commodities, the tax comprised less than 5% of the final price, while mark-ups of various kinds ranged up to 400% and 500% of the cost of manufacturing.

The Minister opined that with the possible exemption of alcoholic products, the other commodities did not appear to be uncompetitive as a result of the Tax and suggested that apart from smuggling, the impact of generally depressed economic conditions was to be taken into account. He suggested that the issues of quality control and appropriate pricing and cost control were to be addressed by the manufacturing sector itself.

1991

The most common of the higher bands of consumption tax was reduced from 50% to 40% and the Consumption tax charged on cars of 1600cc reduced from 50% to 30%.

1992

In 1992, the specific duties levied on domestic manufacturers including spirituous alcoholic beverages, beer and matches were converted to the equivalent *ad valorem* rates. Seventeen groups of alcoholic beverages, which previously attracted specific Excise duties, were accorded *ad valorem* rates.

The Schedule to the Consumption Tax Act which sets out the rates payable on various items was amended to reduce from 30 and 10% to zero the rates on 33 categories of essential goods including medicines, essential foods, educational materials, sports goods and recreational goods. Consumption Tax on cigarettes and tobacco was reduced from 150 to 100%.

The Minister also announced that the rates on similar items considered substitutes would to be rationalised and rates made comparable, one of the recommendations contained in the Crittle Report.

1993

In 1993, the Minister of Finance announced a review of the C-Tax law designed to meet the following objectives:

- Assisting the small farmers in resuscitating the poultry and meat industry;
- Allowing for higher acreage of food crops to be put into meaningful production;
- Stimulating the local manufacturer to produce for local consumption and exports on a competitive basis; and
- Ensuring an abundant and cheap supply of food to the populace.

To meet these objectives, he announced that Consumption Tax on all inputs required for the local production of consumer goods would be waived. Such inputs included *inter alia*, hatching eggs, incubators and concentrates for the manufacturing and processing industries. Duty and Consumption

Taxes on tractors, ploughs, harrows and combine harvesters, required for agricultural production by small farmers would also be waived.

1994

In the 1994 Budget Presentation, the Excise Tax was eliminated in favour of integration of the taxation of the relevant goods with the Consumption Tax.

The Consumption Tax Act was amended to include broad categories of domestic and imported goods at a zero rate, a 10% rate and a 30% rate. Two special rates were assigned for the differential treatment of petroleum and the so-called "sin" items, namely, a 50% rate and an 85% rate.

The Purchase Tax on automobiles was restructured and maintained to allow the Government flexibility to address overall tax rates on automobiles without having to modify the consumption tax schedule.

1995

In 1995 Consumption Tax at the rate of 10% became applicable to overseas telephone charges and to bets – to be borne by the consumer and punter respectively.

At the same time the rate of Consumption Tax on fruits and vegetables was increased to 30% while C-Tax payable on machinery, equipment and materials used in manufacturing, forestry and mining, agriculture, and construction was reduced to zero.

1996

In 1996 the Minister announced:

1. That selected plant, machinery and equipment would be added to the existing list of zero-rated items.

2. A Special Incentive Regime for Linden and surrounding communities including:

- Consumption Tax and duty free concessions on all plant, machinery and equipment
- Consumption Tax and duty free importation of all spare parts
- Tax Concessions for vehicles to be used exclusively for business operations.

1997

In 1997, Consumption Tax on aviation fuel, specifically on Av Gas and Av Jet reduced from 50 and 30 percent, respectively, to 10 percent on the condition that the Aircraft Owners Association would pass on the consumption tax savings to consumers – mining, forestry and tourism sectors by reduction of fares to interior destinations.

1998

There was no announcement in the budget presentation.

1999

The maximum rate under the Common External Tariff was reduced from 25% to 20% with a view to benefiting the consuming public.

2000

No changes were announced in the budget, but during the course of the year with the incidence of rising fuel prices internationally, the Government thrice reduced the rates of C-Tax payable on fuel from 50% to 40%, to 35% and finally to 20%.

2.1.2 Administration of C-Tax

The Act falls under the Commissioner of the Customs and Trade Administration Department of the Revenue Authority who is authorised to do all such acts as may be deemed necessary and expedient for raising, collecting, receiving and accounting for the tax.

Every person registered under the Act is required to keep records in a form acceptable to the Commissioner and must produce these for inspection by any person authorized by the Commissioner.

One concern of manufacturers is the degree of paperwork imposed on them by the Act. These include returns on a monthly basis of the following:

- Monthly consumption tax returns in quadruplicate (to be submitted not later than the 15th of the following month)
- Statement of sales (to accompany returns)
- Consumption Tax Account, properly audited and made up to the end of each month

The survey questionnaire indicates that smaller manufacturers spend a fair amount of time on C-Tax related matters while in the larger operators as many as four full-time staff are dedicated to C-Tax matters.

The Welling Report – Recommendations Relating to the Control of Consumption Tax - deals extensively with the strengthening of the enforcement infrastructure and mechanism which should help to reduce evasion and increase C-Tax revenues.

2.1.3 Outline of the Current System

C-Tax is applicable to chargeable goods imported into Guyana or manufactured or acquired here, except certain services and chargeable goods imported or acquired as materials for and used as such by a registered manufacturer. “Chargeable goods” are any goods specified by Order by the Minister.

Services which are taxed are overseas telephone calls and betting services. However these are taxed under the Tax Act but administered by the Customs Department.

The tax is payable in relation to:

- imported chargeable goods as if the tax were an import duty imposed upon duty imposed under the Customs Act.

- goods manufactured in Guyana at the time of delivery of the goods from the premises of the registered manufacturer or the appropriation of such goods for consumption in Guyana.

- The value to be used for the determination of the tax in respect of imports is the Customs value of the goods plus the customs duty thereon. For goods manufactured in Guyana the value is the "price which in the opinion of the Commissioner, the goods would fetch on a sale made at the time when the tax becomes due by the manufacturer selling on the open market".

It has been consistently argued that the basis of the value discriminates against domestic manufacturers *vis a vis* importers since domestic Consumption Tax is levied on the sale price inclusive of trader's margin whereas on imports the tax is levied on the landed duty paid price exclusive of trader's margin. The GMA and the World Bank have argued that there is both double taxation on the domestic manufacturer and dissimilarity in the points at which the tax is chargeable.

As Crittle points out on page 5 of his Report, since Consumption Tax is collected on behalf of the Government it does not enter into the books as sales and there is no double taxation. In respect of the second point, it is worth noting that most domestic manufacturers are also distributors and pay C-Tax on their retail price. Some companies address the problem by setting up a separate distribution company while other companies including the larger ones treat the C-Tax as calculated by reference to a deemed ex-factory price by taking their manufactured cost of goods as the amount on which consumption tax is payable regardless of the selling price. Most manufacturers however, (incorrectly in our view) treat the selling price as the price on which they charge consumption tax. In order to remove any inequity it is important that C-Tax be applied at the point at which the good enters the domestic distribution and retail chain. This would be the exact point at which imported goods enter the distribution system. It will however require a system of costing and accounting which may not exist in most small and medium sized entities. The GMA should not only make representation to resolve the uncertainty but also assist them in strengthening their costing system.

Small businesses are exempt from registration under the Consumption Tax (Exemption from Registration) Order. This Order was made in 1972 and sets thresholds of $10,000 per annum, and in the case of a business engaged in the manufacture of furniture or of gold or silver jewellery of $50,000 per annum. Clearly these values are no longer meaningful and the threshold needs to be substantially increased.

There are currently two hundred and sixty nine (269) registered manufacturers and they are exempted from C-Tax on all directly imported inputs and all domestically produced inputs purchased from registered manufacturers. It appears that many manufacturers are not aware of this as in their response to the Survey Questionnaire only one entity indicated that it pays no Consumption Tax on input. The exemption would normally be a substantial incentive for compliance but it is widely believed that a significant number of persons do not register. It seems that one reason for non-compliance is that the probability of detection is very low or the penalties not of a sufficient deterrent.

The Guyana C-Tax system is similar to that of Antigua and Barbuda. In practice however, Antigua does not apply the tax to domestic manufactures which is in breach of Caricom Trade Rules.

Rates

The rates of Consumption Tax are set out in the Schedule to the Act. This Schedule is regularly amended and it is almost impossible to obtain a copy of the Schedule with all its amendments. The last major amendment was made in 1994 by Order No. 9 of 1994. There are six rates *viz* 10% for all items not otherwise specified in the Schedule, jet fuel and aviation spirits, 20% for diesel oil, 30% for the majority of items including food, furniture etc., 50% for alcoholic drinks, 85% on other manufactured tobacco and tobacco substitutes, and 128% for cigars, cheerots, cigarettes and similar products.

Remissions

Section 18 of the Consumption Tax Act specifies that for the purposes of remission or refund of the tax the provisions of the Customs Act apply. The Act allows the Minister considerable discretionary powers to remit the tax on any item for which it is deemed just and equitable or in the public interest to do so.

It should be noted that under certain laws and conventions, entities such as the Diplomatic Community and the international organisations, Consumption Tax is exempted. Remissions on the other hand refer to waivers granted by the Minister of Finance under authority of the legislation referred to above. Items brought into Guyana by remigrants enjoy a preferential 5% rate.

Economic allocative efficiency demands that exemptions be either abolished or minimised; administrative efficiency demands that any system for tax exemption be simple, open and demands that any system for tax exemption be simple, open and automatic whilst equity demands equal access and treatment. Export subsidies and exemption to manufacturers who export are popular because of the foreign exchange earnings. They do however narrow the tax base, distort resource allocation and discriminate between domestic and export manufacturing and against local consumers. The current system of discretionary exemptions provides little in the way of guidelines or criteria other than it be deemed "fair and equitable" by the Minister. As such, access is uncertain and the system cumbersome and opaque.

Remissions are very significant and the major beneficiaries include persons benefiting under a category of goods relieved of duties/ tax, diplomatic missions, international organizations/ personnel, Government/ Government purposes and contracts and Item 4 of the CET. In 1999 remissions for these were:

C461 - Goods relieved of duties/ tax - G$18,854,583,735
C414 - Diplomatic Missions, International Organisation and Personnel - G$1,018,378,685
C472 - Diplomatic Missions, International Organisation and Personnel - G$123,884,106
C470 - Government and Governmental Purposes - G$39,390,633
C475 - Government Contracts - G$30,692,217
C464 - First Schedule Part III B (1) Item 4 of Common External Tariff (Raw materials used by

registered manufacturers) – G$8,051,838

Source: Customs & Trade Administration

Previous Tax Changes

In Guyana, rates of taxes, in particular taxes on consumption and customs duties, have been reviewed and reduced during the 1990s. The rates were considerably higher compared with other international rates and most rates now range between 10% and 30% with a few remaining very high, e.g. those on alcoholic and tobacco products.

The Economic Recovery Programme launched in 1989 had as two of its objectives, the widening of the tax base and the lowering of rates. Successive administrations since 1991 have undertaken a number of reforms aimed at rationalising the tax bases and rates for both direct and indirect taxes. However, the tax base remains narrow and there have also been some reversals. Some significant examples are the abolition and then the re-introduction of tax holidays, annual tinkering with the consumption tax and the personal allowances in respect of taxation of individuals. Other measures which have seen reversals include Minimum Corporation Tax and the rates of Corporation Tax.

The number and frequency of these changes suggest a year-to-year tinkering, rather than the implementation of a well-thought-out medium-term strategy. One report[2] has suggested that the tax system appears to be going beyond its narrow tax-collecting function to underwrite a significant interventionist role for government in the economy. This has resulted in a significant erosion of the potential overall base, reflects attempts by the authorities to solve a number of wider socio-political problems, encouragement of investment especially in underdeveloped regions of the country, etc., which the tax system may be unable to address without significant consequences. It is generally accepted among a body of economists, that any such financing of wider objectives is best carried out not through permitting an undefined and formal erosion of the revenue base, but rather in a more targeted and transparent fashion through the expenditure side of the budget or by way of a wider tax reform.

2.1.4 Weaknesses in the System

The recently revised National Development Strategy Report addressed some of the defects of the current tax system in Guyana. Some of the issues raised in connection with customs duties and consumption taxes in that Report and other studies including the IMF Report[3] are as follows:

- ✓ High rates of taxes encourage evasion, and to the extent that they are enforced, discourage investment and production. The NDS noted that because of its small economy, Guyana's future prosperity depends largely on its ability to increase exports. Taxes charged on inputs and income effectively decrease the profitability of export products.

[2] IMF Fiscal Affairs Department, *Guyana: Toward a Medium-Term Strategy for Reforming Tax Policy and Administration*, (2000): p15
[3] Ditto: p6

- ✓ High rates also encourage exemptions and calls for tax holidays which result in a structure capable of modifications at the discretion of the Minister. In Antigua, whilst the rates can be modified by the Minister it can only have a permanent effect after being passed by the House of Representatives.

- ✓ The inconsistent tax rate creates economic inefficiency, lack transparency and is subject to abuses of exemptions and tax holidays.

- ✓ Many rates have been reduced to zero while many others are at 30% and in some cases higher. The NDS suggested a reduction of the tax burden by introducing a lower uniform rate instead which will protect the government's revenue targets and reduce the burden on consumers.

- ✓ Domestic Consumption Tax is levied at the point at which a good enters the domestic distribution and retail chain and therefore includes the producer's margin but not the wholesale or retail margin.

- ✓ It appears that the incentive to avoid the tax is very high while the perceived cost of non-compliance is very low. It is the view of most economists that non-compliance can be significantly reduced by reducing the rates and simplifying the structure. This argument assumes, however, that mechanisms and procedures exist and are practised to detect evasion and enforce compliance. Where this is not the case no rate reduction is likely to encourage compliance to the extent necessary to increase net revenue collections.

- ✓ Similar products may attract different rates e.g. fruit juices (a health food) is taxed at the rate of 30% while fruit drinks are taxed at the rate of 10%, bags used for packaging non-domestic produce are subject to C-Tax of 30% and for domestic produce nil, and packaging for food 30%.

- ✓ Garments, which are listed at 30% in the law, were granted a zero rate following representation made by one of the country's larger garment manufacturers.

- ✓ The Crittle Report drew attention to the loose definition of taxable product and cited an example where the Commissioner ruled that wrapping material used by confectionery manufacturers is not exempt from C-Tax even though it is to be used as material input.

This appears inconsistent with the intentions and indeed the provisions of the Act.

To avoid such ambiguities and uncertainties, it would be preferable if incentives were offered to industries by way of a Schedule to the Act as in the case of the Income Tax (In Aid of Industry) Act. This will allow for a better structure and transparency according to the type of activity and not the type of products. The Act can also specify rates according to industries set up in designated areas for example in Linden, Bartica, etc.

As an expenditure tax, Consumption Tax is usually borne by the consumer. Reductions should similarly be passed on to consumers but this does not always happen in practice, particularly on input C-Tax where experience has shown, as in the case of av gas and stone that the price to the consumer does not reflect the rate reduction.

2.1.5 Analysis of Comments by Manufacturers/ Importers

Questionnaires were circulated both at the workshops with manufacturers/ importers and by direct mail. The workshops enabled discussion amongst various manufacturers and importers along with executives of the GMA and Private Sector Commission.

Some of the more popular comments which were made in relation to C-Tax follows:

- C-Tax is a burden on the manufacturers the way it is structured right now and there is a need for some change";
- "C-Tax is not only a disadvantage but basically a deterrent… In the export market you are looking at the competitiveness situation";
- "Consumption Tax does impact employment".

Although most companies say they pass on C-Tax costs to the consumer, reductions may not be.

<u>Questionnaire Respondents</u>

Questionnaires sought to get companies' views on C-Tax as well as information pertaining to the companies.

Some 74 % of manufacturers who responded to the survey questionnaire indicated that over 50% of their input is subject to C-tax. Of nineteen (19) respondents only one company responded that all of its inputs are exempt from C-tax. The 74% response is surprisingly high and suggests that companies are not taking full advantage of zero rates and exemptions.

An overwhelming majority (77.5%) of participants consider the current C-Tax rates too high. This was reflected from the survey group of which 84% (16) pay between 10-35%, 2 which pay 10% and 1 which is exempt.

Sixty percent (60%) consider the system onerous and only 35% considered the administration of the system fair or simple. 27.5% spend more than 20 hours per month accounting and reporting for C-tax while 35% each indicated that they spent less than 10 hours and between 10-20 hours monthly.

The majority of the participants consider that C-Tax negatively impacts competitiveness locally and internationally as well as their company's ability to expand and to upgrade production processes. They express a desire for change now rather than await further consideration of VAT.

An overwhelming 72.5% believe that it would help manufacturers if C-Tax rates were uniform and exemptions removed.

When asked about the effect of smuggling on the equity of the tax system, 90% of the respondents consider it having considerable impact. 72% see weak enforcement structures as having considerable impact.

Sixty-seven percent (67%) of the respondents pass on between 51-100% of the tax burden to customers. Fifteen percent each pass on between 0-20% and 21-50% respectively. In the event that the rates are reduced, the group indicated similar sentiments about the taxes they intend to pass on.

The majority of companies (53%) generate an annual revenue of over $50Mn with several of them exceeding $300Mn and at least two whose revenue is in excess of $4Bn.

2.1.6 Profiles of Four of the Top Five C-Tax Payers

<u>Banks DIH Limited</u>

Banks DIH, the largest manufacturer and payer of C-Tax, in responding to the Questionnaire notes that over 50% of its inputs is subject to C-Tax and the bulk of its revenue is generated from products subject to C -Tax at very high rates.

The C-Tax on imports is included in its cost/ price and the company computes the tax on the ex-factory price. Any rate reduction would be automatically passed on.

While the Company spends more than twenty hours per month accounting and reporting for C-Tax and is visited by a C-Tax Officer on a monthly basis, it considers the system for accounting and reporting fair.

The Company considers the rates of C-Tax to which they are liable high - particularly on beer, rum and wine - a threat to their competitiveness locally and internationally. It supported the GMA's original proposal for a uniform 10% tax and removal of exemptions.

In 2000 the company paid approximately G$2Bn in taxes of which G$.17Bn or 80.5% represented C-Tax and excise duty payments.

The high cost significantly affects the company's ability to develop technologically and it supports the immediate reform of the C-Tax system rather than delay for the introduction of VAT.

<u>Demerara Distillers Limited</u>

As compared to Banks DIH Limited, a smaller percentage of inputs (0-20%) is subject to C-Tax. However, the alcoholic and aerated products are subject to C-Tax at 50% and 10% respectively.

Like Banks DIH, the company passes on the tax to the consumer and states in the questionnaire that it will pass on the bulk of any reduction received thereon.

While the company considers the rate of C-Tax high and a significant barrier to competitiveness, the rate has only a moderate impact on the company's ability to upgrade production processes and technology. The company spends more than twenty hours per month accounting and reporting for C-Tax and has a C-Tax Officer based at the Factory/Bond.

Whilst the Company supported the uniform rate of 10% and the removal of exemptions in the GMA's original proposal, it did not support the elimination of duty free concessions and remissions. It however feels that the reduction of C-Tax should be delayed pending the completion of the study on Value Added Tax.

In 1999 the company paid consumption taxes and duties of approximately G$1Bn.

National Milling Company

Namilco pays C-Tax on less than 20% of its inputs and pays 10% on the selling price. The company considers C-Tax rates high, even though it benefits from exemptions on imports. The administration of the system is not considered a major problem for this company since it feels it is fair, spends less then ten hours monthly for accounting because of computerisation and is visited by a C-Tax officer very infrequently.

The company supported the GMA's original proposal which offered the same rate which the company is enjoying. The GMA supports the company's request that in an effort to control the cost of living of which flour plays a major part, the rate of 10% should continue to apply to the company.

The company states that it considers C-Tax having moderate impact on the company's ability to upgrade technology but notes that it did not affect the company's recent re-tooling of its plant since most of the machinery was exempt from taxes.

The manner of charging C-Tax on the invoice price automatically passes on the tax to the buyer who would therefore benefit from any reduction. Between 51-100% of the tax burden is passed on to consumers and the company intends to pass on the same portion of a reduction, though it is unlikely that there will be any change.

Torginol (Guyana) Limited

Torginol (Guyana) Limited, part of the Continental Group of Companies supported the GMA's original proposal and would like immediate reform of the current C-Tax system as opposed to awaiting the introduction of VAT.

The reasons for support of the original proposal are:

- the high rate of C-tax - 30% on its products;
- the onerous system of accounting and reporting (more than 20 hours monthly);
- significant barrier to local and international competitiveness;
- high impact on the company's ability to upgrade.

Imported material represents between 40-60% of the final product and most of the tax burden is passed on to consumers.

The company complains that it operates at a disadvantage in relation to those companies which smuggle competing goods into Guyana and which are then sold at unfair prices.

2.2 Other Caricom Countries

2.2.1 Barbados

On January 1, 1997 Barbados introduced the VAT system which replaced prior legislation which taxed goods imported or manufactured in the country. The old system did not apply to services and granted numerous exemptions, particularly on manufacturing and agricultural inputs. Caricom imports and Barbados manufactured goods bore a 0% rate. Other rates ranged up to 39% with a few higher rates for motor vehicles, alcohol, tobacco, etc.

VAT is charged on a wide range of goods and services in Barbados as well as on importation of most goods with the exception of certain items. A standard rate of 15% is charged. Exempt supplies include principally services while zero-rated supplies include export of goods and related services, printed matter and agricultural equipment.

It replaced consumption tax, customs duties, hotel and restaurant sales tax, service tax, tax on certain minerals, airline service business tax, travel ticket tax and telecommunications tax but not Excise Tax which was rationalised as part of the VAT tax reform and which has since generated substantial amounts of revenue as the following table shows:

1995/96	1996/97	1997/98	1998/99	1999/00
312,301	353,008	620,755	644,524	625,897

Figure 2: C-Tax, VAT and Excise Tax Revenue Collected between 1995-2000 in Barbados
Source: Ernst & Young Barbados
All figures in BDS$000

Statistics taken from the 2000 Statistical Digest published by the Barbados Central Bank show a dramatic increase in the total taxes on goods and services since the introduction of VAT and the rationalisation of other taxes.

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Figure 3: Barbados Goods & Services Tax Revenue
Source: Ernst & Young Barbados

2.2.2 Trinidad & Tobago

Unlike Barbados the introduction of the VAT did not eliminate customs and excise duties which are still imposed under the Customs Act by the Comptroller of the Customs. As a signatory to Caricom's CET, duties are levied *ad valorem* on goods imported from outside the Caricom region at rates varying from 2.5%-25%. Excise taxes are imposed on certain locally produced goods, primarily liquor, beer and cigarettes.

VAT is charged on a wide range of goods and services within Trinidad and Tobago, as well as on the importation of most goods into the country with the exception of items, including capital items imported for a temporary period only. Essential services and basic foodstuffs are zero rated whilst certain services are exempt from VAT. The standard rate of tax is 15%.

Revenue TT$000	Revised Estimates 98/99	Revised Estimates 99/00	Estimates 00/01
Total Revenue	13,930,706	16,767,714	16,611,970
Taxes on Goods and Services	3,191,653	3,073,977	3,464,530
VAT	1,852,000	1,835,000	2,222,030
Excise Duties	891,668	806,195	838,000
Other Duties	447,985	432,782	404,500

Figure 44: Total Revenue & Taxes on Goods & Services in Trinidad
Source: Ernst & Young Trinidad

2.2.3 Jamaica

Jamaica in 1991 implemented General Consumption Tax (GCT), a form of Value Added Tax which is chargeable on certain goods and services and imports.

Like both Barbados and Trinidad, the rate of tax charged is 15%. GCT is accompanied by the Special Consumption Tax (SCT), which is an excise tax and which is levied on the manufacture for sale in Jamaica and the import into Jamaica of prescribed goods i.e. petroleum products.

GCT and SCT replaced the consumption tax duty, retail sales tax, telephone services tax, hotels tax and the relevant parts of the excise duty. Exemptions have been extended to GCT.

Customs duties are levied *ad valorem* on the customs value of imports. Imports from other Caribbean countries are exempt through the CET.

Production levies are imposed on banana growers, bauxite and alumina producers, coffee growers, sugar cane farmers and sugar manufacturers but these levies are not part of the Government's consolidated public revenue.

Financial information is not available on this country.

2.2.4 Antigua

The Consumption Tax is imposed by the Consumption Tax Act which became operative from January 2, 1995. The system which is almost identical to the Guyana system charges tax on all goods imported into the country for consumption there, and on all goods manufactured, produced or grown there for local consumption. In practice however, the tax is not chargeable in respect of raw materials imported or *manufactured for use in manufacturing in Antigua*.

The Tax is administered by the Customs and Excise Department, headed by the Comptroller of Customs under the Ministry of Finance. It is payable by the importer or by the seller in the case of manufactured goods, at the time the import's entry is documented or upon withdrawal from bond and at the time of sale of the manufactured items.

Consumption Tax rates may be varied and exemptions may be changed by Ministerial Order, but for any alteration to have permanent effect it must first be sanctioned by the House of Representatives.

Imports of materials to be used by the Free Trade and Processing Zone enterprises for construction and manufacturing are tax exempt along with boats, vessels and aircraft for use in fishing, shipping and approved air services. Antigua however, does not fully comply with Article 24 of Protocol IV: Trade Policy (Amending the Treaty Establishing the Caribbean Community) which provides:

"1. Member states shall not:

> *(a) apply directly or indirectly to imported goods of Community origin any fiscal charges in excess of those applied directly or indirectly to like domestic goods, or otherwise apply such charges so as to protect like domestic goods; or*
>
> *(b) apply fiscal charges to imported goods of Community origin of a kind which they do not produce in substantial quantities, in such a way as to protect the domestic production of substitutes which enter into direct competition with them and which do not bear, directly or indirectly, in the country of importation, fiscal charges of equivalent incidence.*

Antigua does not apply C-Tax to domestic manufacturers or on local produce but applies it in relation to Caricom imports in breach of Article 24.

Effectively the original request by the GMA constitutes a form of discrimination repugnant to Article 24. Subsequently the GMA changed its request to conform with this Article.

CHAPTER 3

PREVIOUS STUDIES

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CHAPTER 3 - PREVIOUS STUDIES

3.1 Welling Report

In a study financed by the British Development Division for the Caribbean Overseas Development Administration, Michael Welling, Senior Adviser on Trade Facilitation and Customs Procedures in the United Nations Conference on Trade and Development (UNCTAD) prepared a Report on the establishment of a new consumption tax control programme.

The main recommendations of the report were:

- to make regular annual control visits to all registered traders;
- to reduce the number of traders not making returns;
- to identify and register all unregistered manufacturers;
- to prosecute under Section 25 of the Consumption Tax Act, registered traders who persistently fail to make tax returns;
- to prosecute under Section 25 of the Act registered traders who persistently fail to keep, preserve or produce records and accounts as required by Section 17;
- to prosecute under Section 25 of the Act, registered traders who fraudulently or recklessly underpay consumption tax;
- to increase consumption tax collected on the manufacture of chargeable goods in Guyana; and
- to provide management information on the progress of the Control Programme for monitoring purposes.

The Report suggested the following:

- research into analysis of ratios which can be used for checking returns
- collection and maintenance of costing information for various types of chargeable goods
- maintaining a register of traders along with accounting records as well as particulars of visits made by C-Tax officers
- preparing a monthly progress report

The Report was prepared for implementation in July 1993.

3.1.1 Action taken on the Report

We are not aware of the extent to which the recommendations of this Report have been implemented.

3.2 Beauregard Report

Cloris F. Beauregard was appointed Sole Commissioner to enquire into the problems facing the Private Sector in Guyana and to make recommendations therewith and on all other related matters. The Report was submitted in July 1991.

The Report dealt with the problems inhibiting the Guyana Private Sector in its effort to expand, and sought to make recommendations to enable the private sector to assume a more dynamic and dominant role in the economy. Consumption Tax was not a principal focus of the Report, but the Report does contain the following on the subject:

> *"As far as the consumption tax is concerned, it was a highly debated issue being described as burdensome and stifling productivity. To compound this situation, it was pointed out that similar foreign commodities enter the country illegally, pay no duty or consumption tax and compete with locally manufactured goods"*

The recommendation in respect of taxation was that "a serious study of Guyana's fiscal system be undertaken by a small team of experts competent in the field, in consultation with the IMF, taking into account the Government's commitment to that institution. Such a study should deal fully with the feasibility of modernising the system by establishing in Guyana the Value Added Tax…."

3.2.2 Action Taken on the Report

This Report has formed the basis of measures announced by successive governments since 1991.

3.3 Crittle Report

This Study and Report was also concluded in 1991 and is entitled "A Review of the Application and Administration of Consumption Tax in Guyana". In addressing the deficiencies in the application and administration of consumption taxes, the Consultant took the view "that such a brief could not be handled adequately unless he addressed the wider issue of indirect taxation and its application and administration. Thus the Study, in addressing Consumption Tax examines and makes recommendations on both excise and import duty application and administration."

While over nine years have elapsed since the completion of this Report, it remains one of the most comprehensive and well-argued examinations of the subject of Consumption Tax. For this reason, we reproduce hereunder a summary of the four options offered to address the difficulties facing the manufacturing sector. So long as Guyana retains Consumption Tax, this Report should be considered relevant in addressing the complaints of manufacturers and the revenue concerns of the Government.

The four options recommended by the Study were:

1. To ignore the study's recommendations and maintain the status quo and retain a multiple level consumption tax rate structure with its incumbent administration complexity, its inherent distortion of production and consumption choices and its significant inherent inducements to evade and abuse the system. This could also include the retention of the current level of non-oil duty exemption on imports and its inherent distortion of resource allocation towards the inefficient domestic manufacturing sector and away from the rest of the economy.

2. To adopt a uniform level of consumption tax at 10%; exemptions for minimum basic needs items; and apply excise duty rates of 15%, 30% and 50% on petroleum refinery products, alcohol and tobacco products respectively. Crittle calculated[4] that this option would be revenue

[4] F. J. Crittle, *Review of the Application and Administration of Consumption Tax in Guyana* (1991): p 60

neutral, leave the overall level of consumer prices unchanged, introduce administrative simplicity, a reduction in the level of consumption and production choice distortion and a reduction in the inducement to evade and abuse the system. Failure to address the issue of non-oil duty exemption on imports would maintain current the current level of resource allocation distortions and their consequent costs to both government revenues and consumer welfare.

3. To adopt the recommended changes to consumption and production taxes and eliminate all non-oil duty exemptions except those required under international agreements. Such a choice would enjoy almost of the advantages of choice 2 above except that the overall consumer price level could be expected to rise by 6% while government revenues could rise by 18%.

4. To eliminate non-oil duty exemptions on imports and utilse the increased government revenues to finance a reduction in the rate of consumption tax to 5%. Such a policy would enjoy all the advantages of choice two i.e. administrative simplicity, reduced distortion, of production and consumption choices, reduced inducement to evade and abuse the system, and revenue and price neutrality. Further resource allocation distortions induced by the exemption policy would be significantly reduced with a consequent increase in consumer welfare. Then benefits of such a policy choice would be felt by all sectors of the community whilst the costs, in the short term, would be borne solely by the manufacturing sector by way of reduced implicit assistance from the government and thus reduced margins. In the longer term industry would adjust by implementing long overdue improvements in productivity in response to the more rational set of price signals.

To assist industry to make the necessary adjustment, Crittle recommended that the government phase the elimination of non oil duty exemptions over three years and consequently delay the adoption of a uniform 5% consumption tax rate until that phased elimination is complete. He recommended that the government announce in advance its intention to eliminate all non-oil duty exemptions over three years and to lower the uniform rate of consumption tax from 10% to 5% at the end of that period. Finally he recommended that the government should negotiate with multilateral development agencies a line of credit to be utilised to provide technical assistance to domestic manufacturers and designed to assist the same to react positively to the more rational set of price signals envisaged under the policy option and to avoid undue adjustment effects such as employment loss. Option 4 was recommended by the Consultant to the government."

3.3.1 Action Taken on the Report

The Government did not accept the Study's well-reasoned recommendations and maintained the status quo. Subsequent Governments have made consistent efforts to reduce the number and high level of rates but compounded the problem of resource allocation distortions by extending the incidence of exemptions, remissions and the items subject to the zero rate.

The Report also raised several issues which continue to exist today although it is not clear why the more obvious ones were not addressed.

3.4 IMF Report

This Report was prepared by the Fiscal Affairs Department of the International Monetary Fund and was in response to a request from the Government of Guyana for a review of the structure of the tax system and its application. The Report was submitted in February 2000.

In summary, that Report recommends the retention of the Personal Income Tax Structure, unification of corporate tax rates, the more sparing use of generalised and specific tax exemptions and most significantly the introduction of a Value Added Tax. The Report only briefly considered the taxation of natural resources and offered no conclusions on the matter. It recommended that the Government seek technical assistance to help it to fashion a medium-term plan for development of the extractive industry for natural resources with a view to capturing a fairer share of the economic rents involved.

3.4.1 Action Taken on This Report

We are not aware of any action so far being taken on this Report.

CHAPTER 4

THE TAX SYSTEM

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CHAPTER 4 – THE TAX SYSTEM

Guyana's tax system is made up of a series of taxes including:

- taxes on income (income tax, corporation tax and capital gains tax)
- taxes on net property (property tax)
- commodity type taxes (levy, royalties)
- taxes on imports (duty and consumption tax)
  - taxes on production (consumption tax)
  - user type taxes (vehicle licences, tolls, etc.)
  - transaction taxes (stamp duty)

The major taxes are administered by the Revenue Authority established by Act 13 of 1996 and made operational in January 2000. The Revenue Authority merged the two principal revenue departments – the Inland Revenue Department now re-designated the Internal Revenue Department and the Customs and Excise Department now called the Customs and Trade Administration.

Guyana has always been rated as one of the highest taxed countries in the world[5]. While the average tax burden of the countries of Latin America for the years 1991-1995 was 14.1% of GDP and that of Asia was 16.8%, Guyana's was a staggering 35%. While the ratio since 1995 has been falling, it is still extremely high even without the inclusion of social security taxes as can be seen from *Figure 8*. The reasons for this are two-fold:

1) Even as the country has sought to narrow its fiscal deficit, the Government has had to invest heavily in physical and social infrastructure to compensate for the substantial deterioration over several years. Accordingly, the country has to collect increasing revenues to meet these additional expenditures by the Government. Any attempt therefore to examine revenues cannot be separated from consideration of the expenditure side of the Budget.

2) The tax base of the country is extremely narrow and there is a widely held view that many sectors and entities do not contribute fairly to the tax revenues of the country. With this narrow base, economic inefficiency, inequity and tax evasion are prevalent and successive studies and pronouncements by consultants, economists and politicians have emphasised the need for substantial tax reform designed among other things to widen the tax base, reduce rates of taxes and remove the deficiencies associated with the current system. See for example, the Reports referred to in Chapter 3.

	1999 G$Mn	1998 G$Mn	1997 G$Mn	1996 G$Mn
GDP at current market prices	120,668	108,002	106,678	99,038
Current revenues	38,643	34,078	33,524	35,117
%	32.0	31.6	31.4	35.5

Figure 5: Tax to GDP Ratio in Guyana (1996-1999)
Source: Guyana Estimates of the Public Sector

[5] IDB, *Economic and Social Progress in Latin America* (1996): p128

Figure 8 details total current revenues and GDP at current market prices for the period 1996 to 1999. Current revenues decreased in 1997 and increased slightly in 1998 and 1999 suggesting that the large increases in remissions (see section 4.5.1) were more than offset by deterioration in the exchange rate and general price movement and increased volume. During the four-year period, consumption tax on domestic production contributed an average of 32.63% of indirect taxes collected in the country.

The projections for current revenues and GDP in 2000 show a ratio of 26.4%. However, preliminary figures announced by the Bank of Guyana show that GDP actually fell in 2000 as compared to the 2000 projected 10% increase while tax revenues increased significantly.

Given the liberalisation of the economy and the deepening of its integration into the world economic system, there is a real likelihood that revenue generally and from international trade specifically will weaken unless corrective measures are taken. The 1999 World Development Indicators Report noted:

> "As countries develop, they typically expand their capacity to tax residents directly and indirect taxes becomes less important as a source of revenue. Thus the share of taxes on income, profits and capital gains is one measure of a tax system's level of development. In the early stages of development governments tend to rely on indirect taxes because the administrative costs of collecting them are relatively low. The two main indirect taxes are international trade taxes (including customs revenues) and domestic taxes on goods and services."

4.1 The General Revenue Structure in Guyana

As economic development in Guyana takes place and the country becomes more integrated into the hemispheric and international trading arrangements, the country will have to rely increasingly on domestic taxes including taxes on domestic production and consumption. It is therefore very important that whatever tax is introduced captures all economic bases and that remissions and exemptions be reduced to an absolute minimum. The National Development Strategy firmly recommends the introduction of a Value Added Tax on both goods and services. VAT has also been strongly recommended by the IMF Study referred to in this Report.

Not everyone however, shares the view that Guyana is in a position for the implementation of VAT. There are very severe data limitations which demand that any analysis and revenue impact be treated cautiously. It appears as well that sufficient work may not have been done in examining the entire tax system and while in principle this study is in favour of VAT, it considers it appropriate that any major change in the tax system be preceded by comprehensive tax reform in which all stakeholders have participated.

4.2 Equity

One of the features of our tax system is the extent of discretionary exemptions and reliefs granted by the Minister under the various Tax Acts. There is evidence that the tax system is being used not only for revenue collection purposes but also to help individual entities and to facilitate Government intervention in the economy. This distorts resource allocation, creates a further erosion of the tax base and makes reduction of rates all the more difficult. It also means that entities in the same industry may be treated differently for tax purposes in a manner that is neither efficient, transparent nor equitable.

One of the cardinal features of the tax system requires that there be no distortion in the allocation of resources and that exemptions be either abolished or minimised. While this is recognised in any discussion on the fiscal system, over the past few years the extent of exemptions and remissions appears to have increased. The current system of discretionary exemptions provides little in the way of guidelines or criteria other than it be deemed "fair and equitable" by the Minister. As such access is uncertain and the system cumbersome and opaque. The official Government Accounts indicate that in 1999 remission of Consumption Tax and Duties amounted to 27.1% of the collections by the Customs and Trade Administration. Owing to the lack of information, it is not possible to compute the cost of tax holidays and other relief measures under the legislation falling under the Internal Revenue Department.

Officers of the Customs and Trade Administration have indicated that the rates of Consumption Tax could be reduced without any revenue loss if more caution is exercised in the granting of remissions.

4.3 Incentives

In 1994 tax holidays were abolished, but re-introduced in 1998. The re-introduction of the open-ended tax holiday did not appear to be the result of any serious analysis, but a response to calls from the business sector. There has been nothing in the history of Guyana or in countries with similar characteristics to suggest that tax holidays have contributed to investment and development. According to the IMF:

> *"Analytical studies have shown that the most effective general tax incentive is not the open-ended tax holiday but targeted accelerated depreciation for plant and machinery expenditure. This is because once such holidays are granted, there is a tendency for the tax administration to lose all interest in monitoring subsequent performance because no tax is involved. In many countries, such companies do not even revise their original feasibility studies to present these to the tax authorities together with their tax returns. If on the other hand there were to be a close monitoring which involved filing returns on a programme basis, this would enable the tax authorities to compute the tax forgone and/or, the losses carried forward on a regular basis. As a result of a lack of monitoring therefore, tax holidays originally granted for a fixed period effectively convert into ones for an indefinite period, implying a permanent revenue loss. On the other hand, targeted accelerated depreciation for plant and machinery encourages the upgrading of capital stock through new investment, thereby promoting economic efficiency."*

While it would be politically difficult for the Government to now revoke the re-introduced tax holiday provision, it needs to ensure that any holidays granted in exceptional circumstances, only after very careful consideration, and that mechanisms be effected to properly monitor the companies.

4.4 Tax Revenues

Before discussing the reported revenues of the country, it is necessary to point out that notwithstanding the impressive improvements over the past eight years, published financial information suffers from a number of defects.

The information problems facing the analyst or policy maker are not confined to timeliness or format but very significantly, accuracy as well. For example, the National Estimates reflect nil for Consumption Tax on services (betting shops and overseas telephone calls) which is obviously incorrect.

Unfortunately the system employed in Government accounting does not possess the checks to detect errors of this nature.

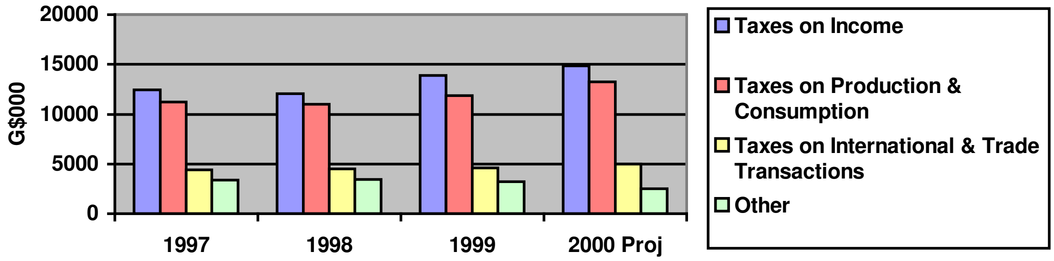

Figure 6: Graph of Types of Current Revenues of Central Govt

Despite the uneven pattern of growth of the economy over the period 1997 to 2000, revenue has increased significantly from G$31.9Bn in 1997 to an estimated G$41.3Bn in 2000. Taxes on income accounted for approximately 40.8% of total tax revenues in 1999 while taxes on production and consumption account for 34.9%. Other taxes including purchase taxes, licences, etc. account for 24.1%.

Of the taxes on production and consumption, taxes on international trade (excluding C-Tax on imports) account for 38.7%.

TYPE OF REVENUE	Actual '97	Actual '98	Actual '99	Proj '00
Taxes on Income	12,454	12,080	13,882	14,842
Taxes on Property	489	460	491	540
Taxes on Production & Consumption	11,227	11,001	11,869	13,255
Imports	7,902	8,097	8,560	9,521
Domestic Manufacturers	3,325	2,626	3,099	3,471
Services	-	278	211	263
Taxes on International & Trade Transactions	4,386	4,480	4,590	5,002
Import Duties	3,702	3,724	3,704	4,029
Export Duties	11	4	8	6
Travel Tax	673	751	879	966
Other	5,340	6,431	8,218	2,558
Entertainment Taxes	36	29	28	29
Purchase Tax - Motor Cars	442	443	427	461
Other Taxes & Duties	2,602	2,567	2,415	1,571
Licenses – Vehicles	160	214	195	227
Licenses – Other	30	31	24	40
Environment Tax	133	140	133	179
Total Tax Revenue	**31,959**	**31,444**	**34,056**	**36,145**

Figure 7: Current Revenues of Central Government (1997-2000)
Source: Guyana Estimates of the Public Sector 99 & 00

(All figures in G$ Millions)

Total tax revenues have increased significantly since the Economic Recovery Programme was introduced in 1989. Current revenue in 1991 was $11.8Bn. In 1995 this figure had jumped to $29.5Bn and in 1999 it was $39.1Bn. If we look at the figures for 1996-1999, we note that taxes on income remained almost constant at approximately 35% of total tax revenue, taxes on production and consumption at approximately 32% and taxes on international trade and trade transactions 13%.

Import taxes and duties accounted in the year 2000 for approximately 38% of total tax revenue. As we noted in Chapter 1, the domestic manufacturing base is small and historically has operated behind quantitative protection and high rates of duty on imports. Usually as development occurs, the domestic manufacturing sector expands and imports of manufactured goods as a percentage of total imports falls. However, development coincided with the opening up of the economy which saw quantitative and fiscal barriers reduced or removed posing new threats to the manufacturing sector.

	1997	1998	1999
C-Tax on Imports/ G$M	**7,902**	**8,097**	**8,560**
% of Total Imports	8.61	8.83	8.89
Duties on Imports / G$M	**3,702**	**3,724**	**3,704**
% of Total Imports	4.03	4.06	3.85

Figure 8: C-Tax and Duties on Imports in Guyana (1997-1999)
Source: Guyana Estimates of the Public Sector

Based on imports data published by the Bank of Guyana, the effective rates of Consumption Tax on imports for the years 1997-1999 have been 8.61%, 8.83% and 8.89% respectively. The average rate of customs duty on imports has been approximately 4% for each of the years giving a combined rate of approximately 13% on imports. Of course, imports as disclosed in the Bank of Guyana Report include Capital Goods e.g. machinery, building materials and other goods, Intermediate Goods (mainly fuel and lubricants which accounts for 35%, other intermediate goods accounting for 27%, and chemicals and parts and accessories accounting for approximately 12% each) and Consumption Goods made up principally of food (34%), other non-durables (19%) and other durables (21%) of this sub-group.

These averages mask wide variations however, since the most common rate of consumption tax on non-food items is 30%.

Notwithstanding this, it appears that there is scope for rationalisation and the application of fewer, lower uniform rates of C-Tax and Customs Duties which would yield the equivalent or greater revenues while making the system simpler, more transparent and less attractive for evasion.

Consumption Tax

C-Tax	1999	1998	1997	1996	1995
Imports	8559	8097	7902	8000	7738
Domestic Manufacturing	3099	2626	3325	3110	2650
Services	211	278	*	208	144
	11869	11001	11227	11318	10532
Growth in C-Tax Revenue	7.9	2.1	-0.8	7.5	35.9

Growth in Domestic Manufacturing	18	-21	6.9	17.4	29.6

Figure 9: Consumption Tax Revenue in Guyana (1994-1999)
Source: Guyana Estimates of the Public Sector
(All figures in G$ Millions)

Consumption Tax is accounted for in three separate categories namely imports, domestic manufacturing and services. Taxes on imports are the most significant contributor to C-Tax revenue collected by the Customs and Trade Administration.

Although the table shows total C-Tax collections over the six-year period 1995 to 1999 increasing by some $4.1Bn, the largest increase ($2.8Bn) occurred in 1995 both on imports and on domestic manufacturing which increased by 50% and 52% respectively. This is despite the reduction in rates and partly reflects changes in the exchange rate and inflation.

	1999	1998	1997	1996	1995	1994	1993	1992	1991
Rate of Inflation (% change in Urban CPI)	8.6	4.6	4.1	4.5	8.1	16.1	7.7	14.2	65
Exchange Rates (US$/ G$)	177.7	152.5	142.7	140.5	141.9	138.2	130.2	125.1	111.8

Figure 10: Rate of Inflation & Exchange Rates 1991-1999
Source: Statistical Bulletin
(Exchange rates are period average)

In 1995 the Government imposed Consumption Tax on two classes of services *viz* overseas telephone charges and bets placed by punters at the rate of 10%. The annual revenue from this source is in excess of $200Mn per year.

4.5.1 Exemptions and Remissions

The IMF recently recommended that the existing scheme of generalised and specific tax exemptions, which constitutes a dampening influence on revenue growth, needs to be fundamentally reappraised with a view to ensuring that new exemptions are granted more sparingly and are more tightly monitored. One of the possible mechanisms is a sliding-scale basis so as to facilitate administrative monitoring and to bring exempted enterprises more quickly into the tax net. The emphasis should be on targeted exemptions for plant and machinery (within the proposed tax depreciation scheme) through accelerated depreciation.

It seems that the structure of incentives under the Income Tax (in Aid of Industry) Act whereby the incentives apply to scheduled industries would be preferable to the discretionary exemptions now granted in a less than transparent manner. This may also extend to designated areas wherein any industry will benefit from generalised concessions.

The annual reports of the Auditor General on the Public Accounts of Guyana indicate the magnitude of the remissions granted on an annual basis. In 1997 C-Tax remissions were $3Bn or 32% of actual collections by the Department and Duty remissions were $2.99Bn. These remissions were made up as follows:

ITEM	DUTY	C-TAX	TOTAL
	$000	*$000*	*$000*
Computer	25,551	11,723	37,274
Petrol	1,393,031	1,500,779	2,893,810
Forestry	239,630	106,672	346,402
Mining	88,735	216,666	305,401
Other	1,245,518	1,182,473	2,427,991
Total	**2,992,465**	**3,018,413**	**6,010,861**

Figure 11: Duty and C-Tax Remissions in 1997

In 1998 C-Tax remitted amounted to $2.34Bn representing 31% of collections by the Department. Remissions in duties were $2.3Bn. A breakdown of the remissions are as follows:

ITEM	DUTY	C-TAX	TOTAL
	$000	*$000*	*$000*
Petrol	1,179457	1,157495	2,336,956
Motor Vehicle	136,400	39,709	176,109
Forestry	23,656	40,899	64,555
Computer	28,609	23,094	51,703
Mining	61,074	141,952	203,043
Others	876,296	940,628	1,817,031
Total	**2,305,492**	**2,343,777**	**4,649,397**

Figure 12: Duty and C-Tax Remissions in 1998

In 1999, C-Tax remissions substantially increased to $3.63Bn whilst remissions on duties had a similar increase to $3.9Bn. Remissions were mainly granted to the following sectors:

ITEM	DUTY	C-TAX	TOTAL
	$000	*$000*	*$000*
Petrol	1,765,847	1,710,483	3,476,330
Motor Vehicle	704,044	224,257	928,301
Forestry	110,088	127,063	237,151
Computer	57,341	7,255	64,596
Mining	222,400	324,253	546,653
Other	1,044,326	1,239,661	2,283,987
Total	**3,904,046**	**3,632,972**	**7,537,018**

Figure 13: Duty and C-Tax Remissions in 1999

This pattern and magnitude of remission has continued over the years and in October 2000 the value of remission was G$1.2Bn. Indeed there are occasions when the remissions in the month exceed collections. Some major international companies operating in Guyana including Omai, Aroaima, Barama, Demerara Timbers and Linden Power Company are exempt from liability to consumption tax under their respective agreements.

For a further discussion on remissions please refer to Chapter 2 – Remissions.

4.6 Analysis of the Top Five Payers

4.6.1 Revenue Yield

Approximately G$12Bn is collected annually as consumption taxes of which $8.6Bn is derived from imports and $3.1Bn from domestic manufacturers. The substantial contribution of C-Tax to total revenue explains the Government's caution in responding to any request for decreases in the rates of C-Tax.

Demerara Tobacco Company Limited was up to September 1997 a major contributor to domestic C-Tax. With the closure of its factory operations in Guyana, it now imports and distributes cigarettes. The company remains a major contributor to C-tax revenues in Guyana via imports.

4.6.2 Contribution to C-Tax Revenue by Five Major Payers

Not surprisingly, given the high rates of C-Tax on alcoholic drinks, Banks DIH and DDL pay the major share of domestic Consumption Tax collected by the Government.

Any reduction in these rates would require special examination of those products and sector which are outside the scope of this study.

With the cessation of manufacturing by Demtoco, the top five payers of domestic C-Tax are Banks DIH Limited, Demerara Distillers Limited, National Milling Company, Torginol Guyana Limited and Edward B. Beharry & Company Limited. It is estimated that in total, these five companies account for approximately 88% of the Consumption Tax received by the Government in 1999.

Of these five entities, the principal products of Banks DIH and DDL are subject to special, high rates of C-Tax. C-Tax paid by National Milling Company is at the rate of 10%. The products offered by Edward B. Beharry and Torginol attract tax at the rate of 30%.

If C-Tax was to be set at a uniform rate of 15% except for alcoholic beverages, tobacco, petroleum products and flour, only $431Mn or 14% of the current revenue from domestic manufacturers would be adversely affected. A few products are taxed at 10% including softdrinks. However, for purposes of this exercise we assume that the C-Tax rate on the entire balance is 30%. If this rate is halved to 15%, the loss of revenue will be half of $431Mn or $216Mn.

Taxes on Production & Consumption	**Actual '97**	**Actual '98**	**Actual '99**	**Projected '00**
Import	7,902	8,097	8,560	9,521
Domestic Manufacturers	3,325	2,626	3,099	3,471
Services	-	278	211	263
Total	**11,227**	**11,001**	**11,869**	**13,255**

Figure 14: Taxes on Production and & Consumption collected in Guyana
(All figures in G$000)
(Source: Estimates of the Public Sector for the years 1999 and 2000)

CHAPTER 5

CONCLUSION & RECOMMENDATIONS

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CHAPTER 5 - CONCLUSION AND RECOMMENDATIONS

No tax allows the Minister of Finance as many opportunities for intervention as the C-Tax. Remissions and exemptions not only narrow the tax base but also introduce uncertainty in the business community while distorting economic choices. Over ten years ago, the then Minister of Finance referred to the “need to redesign the structure of the tax to reduce the incentive for tax evasion, promote economic efficiency and reduce the burden on consumers.” The Crittle Study done one year later made a number of fundamental recommendations[6] to bring about such changes but at best, these have only been partially acted on. That Study recommended a flat rate of Consumption Tax of 10% on all items except alcoholic beverages, tobacco and petroleum products. This Report deals with articles manufactured in Guyana and similar Caricom imports.

Simultaneously, a number of countervailing steps have been taken at the Ministerial level as a result of which the need for reform is perhaps at least as important now as it was then. The pervasiveness and value of remissions and waivers have increased and it is widely believed that widespread evasion continues. It is interesting to note that the request by the Guyana Manufacturers Association, is not dissimilar to the terms of reference of the Study referred to in the previous paragraph.

The case for reform of the C-Tax on economic and equity considerations is extremely strong and has been widely acknowledged. There have been real but tentative steps to more fundamental reform perhaps due to the concerns about potential revenue losses to the government and negative reaction from sections of the private sector. This Report considers that the concerns of the government are valid. Yet there is nothing to suggest that real reform will negatively affect the revenue base.

We note from his 1991 Report (more recent comparable data not available) that Crittle found that a flat 10% with exemptions on basic items and special rates of excise duty on petroleum, alcohol and tobacco products would have had a revenue neutral effect at that time. Conditions since that time have changed but given that this Report considers only manufactured items there is support for its conclusion that there will be no loss of revenue and that the overall thrust of Crittle’s findings remain valid.

5.1 Options Available

The options available to the government range from accepting the GMA’s revised proposal to its rejection with several intervening possibilities. This Report offers three principal options within these two extremes and recognises that there can be a number of permutations of these particularly option 3.

We have noted elsewhere in this Report the unavailability of information relevant to an engagement of this nature. As a result we have relied on information from a number of sources making such assumptions as we considered appropriate in the circumstances. For purposes of this exercise no change is recommended to the basis and rates of C-Tax chargeable on alcoholic, tobacco and petroleum products.

[6] F. J. Crittle, *A Review of the Application and Administration of Consumption Tax in Guyana* (1991): p51-59

The implementation of the recommendations in this Report will bring immediate relief to a number of operators in the domestic manufacturing sector including printing, furniture, paint, confectionery, fruit juices and jams and jellies. This group constitutes a significant proportion of the country's manufacturing base and there is no doubt that the measure will be popular and widely welcome. Manufacturers of alcoholic products have expressed concern about the level of taxation they face and there may be a strong case for a separate review to be done in that sector. The sector may wish to pursue their case with the government particularly with respect to the impact of smuggling on their operations and the revenue of the country.

The following options are available to the Government. It can:

1. ignore the original and revised requests of the GMA and maintain the status quo. This would leave in place the several differential rates, the attraction and scope for evasion and leaving the Government open to criticism that it is unresponsive to the manufacturing sector.

2. move towards a fundamental restructuring of the entire system of taxation leading almost inevitably to the introduction of VAT. However, such a reform is not likely to materialise within the next three years since restructuring should only occur after a detailed, comprehensive study of the structure of the economy and current taxes has been undertaken with the full participation of all stakeholders.

   VAT itself will require a complete set of laws, regulation and public information and education while the administrative structure will have to be created. One of the practical difficulties will be the mobilisation of the requisite skill which is not likely to be readily available.

3. While manufacturers appear to accept the inevitability of VAT they are in favour of immediate steps to reform C-Tax, removing some of the more negative features of the current system, offer some relief to those manufacturers most affected by the current high rates and pave the way for VAT. Among the options if the government favourably considers the request are:

   I. accept the GMA's original proposal and like Antigua, apply the reduced rates to domestic operations only. This however is in breach of Article 24 of the Protocol amending the Caricom Treaty which forbids discrimination.

   II. accept the GMA's original proposal for goods manufactured in Guyana and corresponding imports from Caricom countries with an immediate or phased withdrawal of existing exemptions and zero rates by making all inputs and imports subject to the 10%.

   Both these measures will produce increased revenues while removing the distortions inherent in the current system, reduce remissions and make the entire process more transparent. This is likely to meet with objections from some manufacturers who claim that they will lose their competitiveness. Government should be willing to consider temporary relief within a defined, limited period to allow those companies which prove that the change will seriously harm their business.

   III. accept the GMA's original proposal subject to the following:

a. No discrimination which means that the lowering of the rate will also apply to Caricom imports;
b. Retain existing zero rates for inputs into manufacturing;
c. Reduce the frequency and level of discretionary exemptions.

This will however still have the potential for distortion of resource allocation and continuing calls for zero rates.

IV. modify III above by reducing the rate applicable to domestic manufacturers and domestic services to 15% rather than the proposed 10%. A 15% rate not only guarantees increased revenues to the government but is also likely to be the rate which will apply under VAT.

V. As a variant of IV introduce a flat rate of 15% while retaining the current zero rates and exemptions (the GMA's revised proposal).

5.2 Revenue Implications

The evidence from those Caricom countries which have introduced VAT is that it is extremely revenue productive but since VAT is unlikely to be introduced for some time, and in any case requires work outside the scope of this Study, no attempt has been made to assess its cost and revenue implications.

Subject to the assumptions we have made, each of the options identified results in increased revenues to the Government. The option with the highest estimated net revenue gain ($404Mn) is a flat rate of 15% and removal of exemptions and zero rates now enjoyed by manufacturers. If the exemptions and zero rates are retained, the net gain is $254Mn. The option with the least estimated gain is the flat rate of 10% with the retention of existing exemptions and zero rates enjoyed by manufacturers.

Each of the options anticipates that with lower rates, better enforcement and increased voluntary compliance, revenues from domestic manufacturers other than the non-alcoholic and flour manufacturers will increase by 10%. They also anticipate that with lower rates, and the decision to remove distortions in the allocation of resources, the government will reduce by 5% the value of remissions currently given.

For costing details and assumptions on these options please refer to Appendix 1.

5.3 Recommendation

This Paper for the reason of tax efficiency, resource allocation, reduction of political intervention in the tax system and the removal of uncertainty supports Option 3 II) i.e. a flat rate of 10% and the removal of zero rates and exemptions now available to manufacturers or Option 3 V) i.e. a flat rate of 15% while retaining zero rates and exemptions.

It recommends however, that changes of a more fundamental nature should be made on the basis of a comprehensive tax reform process in which all interested parties have the opportunity to participate.

This Study also recommends that the following steps be taken to advance Consumption Tax reform:

11. That the Reports by Welling, Crittle and the IMF be referred to a Select Committee for review and recommendations.

12. The basis of valuation for purposes of C-tax, particularly in the case of manufacturer/ distributor needs to be clarified.

13. The C-Tax Act and Schedule should be consolidated and simplified.

14. A public information programme should be designed to encourage compliance with the law.

15. There should be established a Statistical Unit in the GRA to ensure that data are collected and maintained in a manner useful for planning purposes.

16. There should be established in the Ministry of Finance, a Tax Policy Unit charged with the responsibility for considering and recommending various options available within the fiscal system.

17. Guidelines subject to the approval of Parliament should be established for the granting of remissions.

18. Certain categories of items which enjoy remission should be reviewed and if necessary investigated.

19. A census of manufacturers should be carried out to bring all manufacturers on the Register.

20. The existing threshold for exemption needs to be reviewed and increased.

21. Systems be put in place to enhance the relationship between the business sector and the Customs & Trade Administration.

5.4 Conclusion

While the benefit of tax reductions should not be underestimated, the challenges facing the manufacturing sector will not be overcome by mere tax changes. Successful manufacturing requires a stable macro-economic environment which fosters allocation efficiency, removes uncertainty and tax discrimination and low rates of tax. It is the view of this Report that annual tinkering has not produced the desired results of simplicity, fairness, efficiency and revenue. As much as ever, the economic conditions demand decisive action for the good of the economy as a whole even though there will be some losers.

The Government may wish to extend C-tax rate reform to all items so that there will be only one rate except for petroleum, alcohol and tobacco.